

# Contracts 101: Make a Legally Valid Contract

**All you need is a clear agreement and mutual promises to exchange things of value.**

Lots of contracts are filled with mind-bending legal gibberish, but there's no reason why this has to be true. For most contracts, legalese is not essential or even helpful. On the contrary, the agreements you'll want to put into a written contract are best expressed in simple, everyday English.

Most contracts only need to contain two elements to be legally valid:

- All parties must be in agreement (after an offer has been made by one party and accepted by the other).
- Something of value must be exchanged -- such as cash, services, or goods (or a promise to exchange such an item) -- for something else of value.

**Does a contract have to be in writing?** In a few situations, contracts must be in writing to be valid. State laws often require written contracts for real estate transactions or agreements that will last for more than one year. You'll need to check your state's laws to determine exactly which contracts must be in writing. But even if it's not legally required, it's always a good idea to put business agreements in writing, because oral contracts can be difficult or impossible to prove.

Let's take a closer look at the two required contract elements: agreement between the parties, and exchange of things of value.

## Agreement Between the Parties

Although it may seem like stating the obvious, an essential element of a valid contract is that all parties must agree on all major issues. In real life, there are plenty of situations that blur the line between a full agreement and a preliminary discussion about the possibility of making an agreement. To help clarify these borderline cases, the law has developed some rules defining when an agreement legally exists.

## Offer and Acceptance

The most basic rule of contract law is that a legal contract exists when one party makes an offer and the other party accepts it. For most types of contracts, this can be done either orally or in writing.

Let's say, for instance, you're shopping around for a print shop to produce brochures for your business. One printer says (or faxes, or emails) that he'll print 5,000 of your two-color flyers for \$300. This constitutes his offer.

If you tell the printer to go ahead with the job, you've accepted his offer. In the eyes of the law, when you tell the printer to go ahead you create a contract, which means you're

liable for your side of the bargain (in this case, the payment of \$300). But if you tell the printer you're not sure and want to continue shopping around (or don't even respond, for that matter), you haven't accepted the offer, and no agreement has been reached.

But if you tell the printer the offer sounds great except that you want the printer to use three colors instead of two, no contract has been made. This is because you have not accepted all of the important terms of the offer. You have actually changed one term of the offer. (Depending on your wording, you have probably made a counteroffer, which is discussed below.)

### **When Acceptance Occurs**

In day-to-day business, the seemingly simple steps of offer and acceptance can become quite convoluted. For instance, sometimes an offer isn't quickly and unequivocally accepted; the other party may want to think about it for a while, or try to get a better deal. And before the other party accepts your offer, you might change your mind and want to withdraw or amend it. Delaying acceptance of an offer and revoking an offer, as well as making a counteroffer, are common situations that may lead to confusion and conflict. To minimize the potential for a dispute, here are some general rules you should understand and follow.

### **How Long an Offer Stays Open**

Unless an offer includes a stated expiration date, it remains open for a "reasonable" time. What's reasonable, of course, is open to interpretation and will vary depending on the type of business and the particular fact situation.

To leave no room for doubt as to when the other party must make a decision, the best way to make an offer is to include an expiration date.

If you want to accept someone else's offer, the best approach is to do it as soon as possible, while there's no doubt that the offer is still open. Keep in mind that until you accept, the person or company who made the offer -- called the offeror -- may revoke the offer.

### **Revoking an Offer**

Whoever makes an offer can revoke it as long as it hasn't yet been accepted. This means that if you make an offer and the other party wants some time to think it through, or makes a counteroffer with changed terms, you can revoke your original offer. Once the other party accepts, however, you'll have a binding agreement. Revocation must happen *before* acceptance.

An exception to this rule occurs if the parties agree that the offer will remain open for a stated period of time.

## **Offers With Expiration Dates**

An offer with an expiration date is called an option, and it usually doesn't come for free. Say someone offers to sell you a forklift for \$10,000, and you want to think the offer over without worrying that the seller will withdraw the offer or sell to someone else. You and the seller could agree that the offer will stay open for a certain period of time -- say, 30 days. Often, however, the seller will ask you to pay for this 30-day option -- which is understandable, because during the 30-day option period, the seller can't sell to anyone else.

Payment or no payment, when an option agreement exists, the offeror cannot revoke the offer until the time period ends.

## **Counteroffers**

Often, when an offer is made, the response will be to start bargaining. Of course, haggling over price is the most common type of negotiating that occurs in business situations. When one party responds to an offer by proposing something different, this proposal is called a "counteroffer." When a counteroffer is made, the legal responsibility to accept, decline or make another counteroffer shifts to the original offeror.

For instance, suppose your printer (here, the original offeror) offers to print 5,000 brochures for \$300, and you respond by saying you'll pay \$250 for the job. You have not accepted his offer (no contract has been formed) but instead have made a counteroffer. If your printer then agrees to do the job exactly as you have specified, for \$250, he's accepted your counteroffer, and a legal agreement has been reached.

Even though a contract is formed only if the accepting party agrees to all substantial terms of an offer, this doesn't mean you can rely on inconsequential differences to void a contract later. For example, if you offer to buy 100 chicken sandwiches on one-inch-thick sourdough bread, there is no contract if the other party replies that she will provide 100 emu filets on rye bread. But if the other party agrees to provide the chicken sandwiches on one-inch-thick sourdough bread, a valid contract exists, and you can't later refuse to pay if the bread turns out to be a hair thicker or thinner than one inch.

## **Exchange of Things of Value**

In addition to both parties' agreement to the terms, a contract isn't valid unless both parties exchange something of value in anticipation of the completion of the contract.

## **Consideration Defined**

The "thing of value" being exchanged -- which every law student who ever lived has been taught to call "consideration" -- is most often a promise to do something in the future, such as a promise to perform a certain job, or a promise to pay a fee for a job. For instance, let's return to the example of the print job. Once you and the printer agree on

terms, there is an exchange of things of value (consideration): The printer has promised to print the 5,000 brochures, and you have promised to pay \$250 for them.

### **Gifts vs. Contracts**

The main importance of requiring things of value to be exchanged is to differentiate a contract from a generous statement or a one-sided promise, neither of which are enforceable by law.

If a friend offers you a gift without asking anything in return -- for instance, offering to stop by to help you move a pile of rocks -- the arrangement wouldn't count as a contract because you didn't give or promise your friend anything of value. If your friend never followed through with her gift, you would not be able to enforce her promise.

However, if you promise your friend you'll help her weed her vegetable garden on Sunday in exchange for her helping you move rocks on Saturday, a contract exists.

### **Promises vs. Action**

Although the exchange-of-value requirement is met in most business transactions by an exchange of promises ("I'll promise to pay money if you promise to paint my building next month"), actually doing the work can also satisfy the rule.

If, for instance, you leave your printer a voicemail message that you'll pay an extra \$100 if your brochures are cut and stapled when you pick them up, the printer can create a binding contract by actually doing the cutting and stapling. And once he does so, you can't weasel out of the deal by claiming you changed your mind.

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